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MEMORANDUM

TO: County Commissioners

FROM: George H. Corn

DATE: December 12, 2007

RE: STIP

I know that you have a meeting tomorrow afternoon and I thought this might help.

Special session for STIP not needed, says investment official

By CHARLES S. JOHNSON - IR State Bureau - 12/12/07

No special legislative session is needed now, but laws may need to be changed in 2009 to address the hemorrhaging of local government funds from Montana's Short Term Investment Pool, the Board of Investments' top official said Tuesday.

Carroll South, the board's executive director, told the Legislative Finance Committee that local governments and school districts withdrew \$425 million from the pool from Nov. 28 through Tuesday — although \$66 million of local money was invested during the period.

The Board of Investments manages STIP, which operates like a money market fund in which state and local governments and schools can deposit surplus cash.

Local governments began yanking their money out of STIP after voicing concerns over the safety of some investments.

Their withdrawals followed a Bloomberg Markets magazine article in mid-November that identified Montana and Florida as states where some pool money is invested in risky funds.

Some \$525 million of the Montana STIP's \$2.1 billion portfolio is invested in what are known as structured investments vehicles, or SIVs. These funds are bought by institutional investors and backed by the underlying assets.

Only \$19.5 million, or less than 4 percent of the assets backing the SIVs, are made up of sub-prime mortgages, which are loans made to people with bad credit. That's less than 1 percent of all STIP assets.

"All the local governments bailing out have not affected the yield," South told reporters afterward.

Operating under what South called "a fear factor," local governments and school districts late last month began reducing their total STIP investment by 40 percent over the past two weeks, lowering STIP's total balance to \$2.1 billion from \$2.5 billion, he said.

"Before the run on the bank began, local governments owned 36 percent of the pool," he said, while the state owned 64 percent. Now the split is 75 percent state funds and 25 percent local money.

"This has been a very troubling two weeks for most of us," he said.

Rep. Dave Kasten, R-Brockway, asked if the Board of Investments should limit local governments' withdrawals to 40 percent to 50 percent of the assets they invested.

"We don't think the law permits it," South replied.

Rep. Ron Erickson, D-Missoula, asked South whether the Legislature should change the law to limit how much money local governments and school districts can withdraw from STIP.

South said the board doesn't need any action immediately through a special session of the Legislature.

Earlier this month, Sen. Dave Lewis, R-Helena, proposed calling one.

"We can live with this to the next session," said South, a former legislator. The Legislature isn't scheduled to meet again until Jan. 2009.

In the 2009 Legislature, South said lawmakers might want to consider making changes that would protect the investments of state agencies, which are forbidden from leaving STIP.

South said he wouldn't want to see the counties with the largest investments being able to pull money out, put it in banks for a week or two and then reinvest it in STIP.

"If Yellowstone County wants to bring \$71 million back in next week, we'll have to take it," he said. "It plays havoc with the underlying portfolio."

South said the Board of Investments began taking steps in August to increase the amount of money available for withdrawals from \$100 million a day to \$300 million a day.

"It's very fortunate we did, or we would be in situation like Florida," he said.

Florida, which is a pool for local governments only, had to cut off withdrawals.

Senate Majority Leader Carol Williams, D-Missoula, asked if bankers were encouraging local governments to pull their money out of STIP and instead put the money in their banks. After all, she said, "It's really to the benefit of the banks if they pull out of this fund."

South said he's heard some banks have offered "a very good deal" for local government investments, but they can't offer 5 percent interest forever. He said Well Fargo was offering 4.14 percent interest when Yellowstone County withdrew money from STIP that was earning 4.75 percent.

Rep. Janna Taylor, R-Dayton, asked if Montana and Florida were singled out by Bloomberg because their investment pools post all of their information on the Internet for anyone to see.

South said very few states are as transparent as Montana.

"We started doing it this way a long time ago. We wouldn't change it," he said.

Two STIP investments also face difficulties: \$90 million invested in Axon SIVs, which have been downgraded to a D rating, triggering a liquidation, and \$50 million in Orion SIVs, which is not yet in liquidation, South said.